Legal and Technical Update

Government Employee Pension Fund (GEPF)

Early retirement offer

In the 2019 Budget the Minister of Finance stipulated measures that government must take to assist with the growing budget deficit which has accrued due to the 2018 Wage Settlement Agreement. The purpose of this was to find measures to ensure that the budget is not exceeded and to ensure job security and to ensure that departments still operate efficiently.

An option to assist with this objective presented itself as a result of employees' continuously requesting early retirement without penalties. And so the early retirement offer came into being.

In terms of section 16(6) of the Public Services Act, employees can be offered early retirement without penalties, subject to the prescribed approvals. Treasury will assist the relevant departments with any budgetary deficits to allow for the early retirement of employees, where applications are approved.

To whom is this offer available and for how long?

This offer is available to all employees, aged between 55 and 60 years, employed in terms of the Public Services Act and includes members of the SA Police Force, SA Defense Force, Department of Correctional Services, employers and members of Intelligence.

The offer is available from 1 April 2019 until 30 September 2019. After this date, the situation will be reassessed.

Will all employees' application be accepted?

No, an application will be considered and various factors will be taken into consideration. Some of the factors that will be considered are:

- Whether the employee's retirement will have a negative impact on service delivery,
- Whether it will result in a skills deficit,
- What the potential future fiscal saving will be, and
- Human resources planning must be considered.

Therefore it is not guaranteed that an employee's application will succeed.

What benefits will accrue if the application is successful?

The normal retirement benefits will apply. The benefits paid depend on whether a member has less than 10 years' pensionable service, or 10 or more years of pensionable service at retirement.

Members with less than 10 years' service receive a gratuity (a once-off lump sum) that is equal to their actuarial interest in the fund.

Members with 10 or more years' service receive a gratuity and a monthly pension (annuity). In this instance the member does not have a choice in the matter. There is no option to transfer the capital funding the annuity income to another compulsory annuity fund.

What is so 'special' about this offer?

Under normal circumstances, members may retire early, meaning before reaching the normal retirement age. The Public Services Act determines that members may retire early between the ages of 55 and 60; however, it will be subject to penalties.

The member's years of pensionable service will once again assist in determining the benefits. Members with 10 or more years of service receive annuities and gratuities. These are calculated in the same way as for normal retirement, but with a reduction (the penalty) of a third of one percent (0.33%) for each month between the dates of early retirement and normal retirement.

During this window period, no penalties will be levied on the retirement benefit.

Additional benefits incidental to early and normal retirement

The following benefits always form part of early retirement or retirement benefits:

- Pro-rata service bonus – this is basically equal to one month's salary and then adjusted downwards for each month in the year that the employee will not be working;
- Leave pay – compensation for unused leave days;
- Compensation for medical assistance (post-retirement medical benefit) - this is based on the number or pensionable service years and the years member to a medical scheme.
    - Different compensation amounts apply depending on year's membership (either more or less than 15 years).
    - Where the years' service is less than 15 years, a lump sum amount will be payable.
    - Where the years' service exceeds 15 years, a portion of the medical scheme contribution will be paid by the government for the rest of the member's life.
- Housing allowance – employees linked to the Government Employee Housing Scheme (GEHS) or the Individual-Linked Savings Facility (ILSF) will be entitled to their accumulated savings;
- Resettlement costs that may apply to retiring employees.

As this is a voluntary early retirement offer, there are no severance or retrenchment benefits payable.

Which factors should one consider when advising a client on this offer?

When advising a client on the early retirement option one must ensure that the client makes an informed decision and that all factors are presented. Some of the most important factors to consider include the following:

- The retirement benefit is calculated using the total year's pensionable service at the time as well as the final salary.
    - When early retirement is taken, the pensionable service at that time is taken into account to determine the retirement benefits, which will inevitably be less that when the client waits for normal retirement.
    - As the client is retiring early, all future increases will be missed. The result is that the potential final salary at normal retirement is sacrificed.
    - It is necessary to illustrate the early retirement benefit compared to the normal retirement benefit to the client to allow them to make an informed decision.

- As the retirement benefit changes when the client has 10 years or more service, it is vital to consider what service the client has at this time compared to the years' service at normal retirement.
- If an employee has more than 15 years' service, the post-retirement medical scheme assistance is very favourable. One has to consider the years' service of the client and the impact the early retirement can have on this future benefit.
- The client's overall retirement plan must be revisited as the change in benefits can have a large impact on the future success of the plan.

What are the other options an employee can consider?

As this is totally voluntary, the employee does not have to apply for early retirement, but can instead either wait for normal retirement or can also consider resignation.

How does the offer compare to resignation?

When a member resigns or is discharged due to misconduct or an illness or injury caused by the member's own doing, the member will have one of two options:

- Be paid a gratuity (a once-off lump sum) which may be subject to income tax; **OR**
- Transfer their benefits to an approved retirement fund. If benefits are being transferred, the GEPF pays the member's actuarial interest to the member's new fund. The amount that is transferred to an approved retirement fund is not taxed at this point and tax is only deducted when the member retires or withdraws and receives a lump sum from the new fund.

The member cannot select a combination of the two options – it is the one or the other.

Note:

- On resignation the member loses the pro-rata bonus, the leave pay lump sum as well as any post-retirement medical aid benefits, housing subsidy, etc. Therefore it is imperative to keep this in mind when a client is weighing up resignation from the fund.
- In addition, if a member resigns vs. retires, the spouse's pension and orphan's pension benefits will also be lost.

When a transfer is contemplated, one must take note of the restriction imposed by the GEPF Law regarding accessibility to the funds, prior to retirement and at retirement. The wording in the GEPF Law is as follows:

> *Such transfer shall be made subject to the rules of the approved retirement fund specifying that, with reference to the transfer benefit, <u>any subsequent lump sum benefit payable by that fund or any successor fund to the member and/or his beneficiaries shall be limited to one third of the said transfer benefit, with interest</u>. The balance of the member's transfer benefit with interest, after deduction of any lump sum payment referred to above, shall be applied for the purchase of an annuity, albeit immediately or upon the member's ultimate retirement.*

There are different interpretations of the rule. However, it is clear that the member may not receive more than one third of the transfer value plus interest. In the case of a pension preservation fund, this restriction must be noted if a member wants to take a pre-retirement withdrawal. Any lump sum amount withdrawn from the preservation fund prior to retirement will therefore impact the ability to receive another lump sum at retirement.

What impact will income tax have on the resignation/retirement benefit?

As all public sector retirement funds were tax exempt until 1998 and all benefits that accrued in the fund up until that time will remain tax-free. Only the benefits that accrued thereafter could be subject to tax when the member received a lump sum due to resignation, retirement or any other reason.

The Second Schedule to the Income Tax Act prescribes the formula to use when determining the taxable portion of any lump sum. It is as follows:

A = B/C x D
A = amount to be determined, which is the taxable amount
B = number of completed years member of the fund after 1 March 1998
C = number of completed years member of the fund
D = lump sum amount

When a member resigns from the fund, the full resignation benefit accrues to the member and therefore this formula is applied to that full benefit amount. If the member transfers the resignation benefit to another approved retirement fund, the tax-free portion will follow to the transferred fund. The result is that if the member makes a withdrawal from that fund or retires from that fund anytime in the future, that tax-free portion will remain and be considered when calculating the taxable lump sum.

If the member retires, the formula is applied to the lump sum, resulting in a portion always being taxable.

Example:

This example is based on the following client:

- Retirement age 55
- Final salary R200 000
- Service start date 1 March 1984
- Finish date 1 March 2019

The following table will compare early retirement with penalties, early retirement without penalties:

Option selected:	Early retirement	Special offer early retirement
Lump sum	R376,350.00 (after penalties)	R470,436.00
Annuity income from fund	R8,509.00 pm (after penalties)	R10,636.00 pm
Lump sum tax	Nil	Nil
Medical subsidy	Yes	Yes